

**Internal Revenue Service**

Department of the Treasury  
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Date:

March 05, 2008

**Legend:**

Taxpayer =

Operating Partnership =

Property =

a =

Date 1 =

Date 2 =

Dear :

This is in reply to a letter dated October 29, 2007, requesting a ruling on behalf of Taxpayer. Specifically, you requested a ruling that the sale of certain real property will not constitute a prohibited transaction under section 857(b)(6) of the Internal Revenue Code by reason of the "safe harbor" provisions of section 857(b)(6)(C), in particular subparagraphs (i) and (iv) of section 857(b)(6)(C).

**Facts:**

Taxpayer is a domestic corporation that has elected to be treated as a real estate investment trust ("REIT") under section 856(c).

Taxpayer is an a% partner in Operating Partnership which operates numerous real properties throughout the United States. Property, the real property at issue in this ruling request, is owned and operated by Operating Partnership and is rented to retail tenants.

The Property was acquired by Operating Partnership on Date 2 in a nonrecognition exchange under section 1031 (the "Exchange"). In exchange for the Property, Operating Partnership relinquished like-kind property consisting of an interest in certain real estate (the "Relinquished Property") and cash. Operating Partnership had acquired the Relinquished Property on Date 1.

Taxpayer represents that at the time of the Exchange, the Relinquished Property was property described in section 1231 and was a "real estate asset" as defined in section 856(c)(5)(B). Additionally, Operating Partnership held both the Relinquished Property and the Property "for the production of rental income" under section 857(b)(6)(C)(iv).

Taxpayer wishes to reconfigure its portfolio of properties, and proposes that Operating Partnership dispose of the Property in a taxable sale after the first fiscal quarter of 2008.

Taxpayer represents that Operating Partnership's combined holding period of the Relinquished Property and the Property is no less than 4 years. In addition, Taxpayer represents that the aggregate amount of cash consideration paid in the Exchange for the Property combined with the total amount of expenditures made by the Operating Partnership during the 4 years preceding the sale of the Property which are or were includible in the basis of the Relinquished Property and the Property will be less than 30 percent of the net selling price of the Property in accord with section 857(b)(6)(C)(ii). Taxpayer further represents that clauses (iii) and (v) of section 857(b)(6)(C) are, or will be, satisfied with respect to the Property.

Taxpayer seeks a ruling that the holding period of the Property includes the holding period of the Relinquished Property under section 1223(1), and accordingly, the sale of the Property by Operating Partnership will not constitute a prohibited transaction under section 857(b)(6) by reason of the application of section 857(b)(6)(C).

### **Law and Analysis:**

Section 856(c) provides that to qualify as a REIT, a corporation must: (i) derive at least 95 percent of its gross income (excluding gross income from prohibited transactions) from sources listed therein which include dividends and interest; (ii) derive at least 75 percent of its gross income (excluding gross income from prohibited transactions) from sources listed therein, including rents from real property and interest on obligations secured by mortgages on real property or on interests in real property.

Section 856(c)(4)(A) requires that, at the close of each quarter of the taxable year, at least 75 percent of the value of a REIT's assets is represented by real estate assets, cash, cash items, and government securities.

Section 856(c)(5)(B) includes in the definition of "real estate asset," real property, including interests in real property and in mortgages on real property, as well as shares in other REITs.

Section 1.856-3(g) of the Income Tax Regulations provides that a REIT that is a partner in a partnership is deemed (1) to own its proportionate share of each of the assets of the partnership and (2) to be entitled to the income of the partnership attributable to that share. For purposes of section 856, the partner's interest in the partnership's assets is determined in accordance with the partner's capital interest in the partnership. The character of the various assets in the hands of the partnership and items of gross income of the partnership retain the same character in the hands of the partners for all purposes of section 856. Additionally, section 1.856-3(g) provides that the holding period attributed to the REIT with respect to partnership property is the lesser of the period that the partnership has held the property or the period that the trust is a member of the partnership.

Section 857(b)(6)(A) imposes a 100 percent tax on the net income a REIT derives from prohibited transactions. Section 857(b)(6)(B)(iii) defines "prohibited transaction" to mean a sale or other disposition of property described in section 1221(a)(1) which is not foreclosure property. Section 1221(a)(1) describes property which is generally used in a taxpayer's trade or business: stock in taxpayer's trade, other property of a kind which would properly be included in taxpayer's inventory if on hand at the close of the taxable year, or property held for sale to customers in the ordinary course of taxpayer's trade or business.

Section 857(b)(6)(C), however, provides a safe harbor excluding from the term "prohibited transaction" certain sales of real estate assets, as defined in section 856(c)(5)(B), if (i) the property is held by the REIT for not less than four years; (ii) aggregate expenditures during the four-year period preceding the date of sale which are includible in the property's basis do not exceed thirty percent of the net selling price of the property; (iii) during the taxable year, (I) the REIT does not make more than seven sales of property (other than sales of foreclosure property or where section 1033 applies) or (II) the aggregate adjusted bases of property sold (other than sales of foreclosure property or where section 1033 applies) does not exceed ten percent of the aggregate bases of all assets held by the REIT at the beginning of the taxable year; (iv) in the case of property which consists of land or improvements, not acquired through foreclosure, or lease termination, is held by the REIT for not less than four years for the production of rental income; and (v) if the requirement of clause (iii)(I) is not satisfied, substantially all of the marketing and development expenditures with respect to the

property were made through an independent contractor so that the REIT did not derive or receive any income from such activities.

Section 1223(1) provides that in determining the period for which a taxpayer has held property received in an exchange, there shall be included the period for which the taxpayer held the property exchanged if, under this chapter, the property received has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in its hands as the basis of the property exchanged and the property exchanged at the time of the exchange was a capital asset under section 1221 or property described in section 1231.

Section 1031 provides for the nonrecognition of gain or loss on a like-kind exchange. Section 1031(d) provides that the basis of the newly acquired property in a 1031 exchange shall be the same as that of the property exchanged, decreased by the amount of cash received by the taxpayer and increased by any gain or decreased by any loss recognized by taxpayer on such exchange. Section 1.1031(d)-1(a) provides that if taxpayer gives additional consideration in a section 1031 exchange, the basis of the newly acquired property shall be the basis of the property exchanged plus the amount of any additional consideration given in the exchange.

Section 1223 is not expressly made applicable to section 857(b)(6)(C) by the Code or regulations. However, in determining whether Operating Partnership held the Property for no less than four years, section 1223(1) provides that the holding period of the Property includes the holding period of the Relinquished Property, because under section 1031 the basis of the Property is the same as the basis in the Relinquished Property, subject to the adjustments specified in section 1031. Accordingly, based on Taxpayer's representations, at the time of the sale of the Property, Operating Partnership will have held the Property for not less than four years, thereby meeting the holding period requirements of sections 857(b)(6)(C)(i) and (iv).

## **Conclusion**

Based on the information submitted and the representations made, we conclude that the sale of the Property falls within the safe harbor provisions of section 857(b)(6)(C) and therefore, will not constitute a prohibited transaction under section 857(b)(6) because, pursuant to section 1223(1), Operating Partnership's holding period of the Property includes the holding period of the Relinquished Property.

No opinion is expressed or implied as to the federal tax consequences of this transaction under any provision not specifically addressed herein. No opinion is expressed or implied concerning whether Taxpayer qualifies as a REIT under subchapter M, part II of Chapter 1 of the Code. In addition, no opinion is expressed or implied as to whether section 1031 of the Code applies to the Exchange or as to whether section 1231 applies to the Relinquished Property.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the power of attorney on file, we are sending a copy of this letter to Taxpayer's authorized representatives.

Sincerely,

Thomas M. Preston  
Thomas M. Preston  
Senior Counsel, Branch 2  
Office of Associate Chief Counsel  
(Financial Institutions & Products)